

Mercer Capital's

Financial Reporting Valuation Flash

Second Quarter 2013

Portfolio Valuation Can Be Complex, Risky

Fair Value Measurement for PE Firms is Under the Microscope

Valuation of PE portfolio investments for financial reporting can be challenging for many reasons. PE investments are, by nature, illiquid. Portfolio companies are not publicly traded, and holding periods are generally long. PE investments often employ complex capital structures that include several tranches of equity, debt or hybrid securities with differing rights to intermediate and exit proceeds. In addition, derivative instruments are also popularly used in incenting management teams.

Increasing Risk of Conflict of Interest

Market participants are increasingly sensitive to (the appearance of) conflicts of interest in PE valuations. In the absence of public, transparent information, investors have to rely on valuation marks provided by PE managers to assess performance, review allocations, determine compensation and fulfill their own reporting requirements. Regulatory agencies, including the SEC, are increasingly scrutinizing valuation practices within PE and other alternative investment managers.

Mercer Capital Has the Technical Expertise to Address Complicated Valuation Issues

In the absence of public price discovery, analysts must rely on or devise models to conduct valuations of portfolio companies and investments. At the same time, accounting principles prescribe maximizing the use of publicly observable inputs in the valuation models. A defensible valuation opinion needs to consider, conduct, and document a number of procedures including historical financial review, independent analysis of public guideline or comparable companies and private transactions, evaluation of acceptable and relevant income methods (capitalization or discounted cash flow), and tests for internal consistency.

Mercer Capital has years of experience in providing third-party valuation opinions on illiquid investments to PE clients' and other stakeholders' satisfaction. Our recent presentation, "Best Practices for Fair Value Measurement," available at <http://mer.cr/pe-val-ppt>, throws some light upon a number of valuation issues specific to PE portfolios.

Hiring an Independent Third-Party Valuation Specialist Reduces Risk of Conflict of Interest

It is vital that analysts exercise impartiality in conducting portfolio valuations. Larger PE funds increasingly rely on valuations prepared by third-party specialists to ensure objective reporting of portfolio investments. Investor-facing groups including the Institutional Limited Partner Association, European Private Equity and Venture Capital Association, and the Alternative Investment Management Association acknowledge and recommend the use of independent third-party valuation specialists.

Contact a [Mercer Capital professional](#) to discuss your needs for independent valuation and consulting services.

Related Resource
Best Practices: Fair Value Measurement for Firms Subject to the Investment Company Act of 1940

Topics in this presentation include: "International Private Equity and Venture Capital Valuation Guidelines," "CFA Institute Global Investment Performance Standards," and "Key Takeaways." Click the image to view the presentation.

Mercer Capital's Portfolio Valuation Services

Mercer Capital provides portfolio valuation services for a variety of sophisticated asset managers including private equity groups, hedge funds, business development companies, and insurance companies. Mercer Capital's services for fund managers, boards of directors, audit committees, and fund administrators include:

- Review of valuations prepared by PE managers
- Positive assurance opinions
- Full appraisals of portfolio companies
- Solvency opinions
- Fairness opinions

Mercer Capital

Financial Reporting
Valuation Services

In an environment of increasingly complex fair value reporting standards and burgeoning regulatory scrutiny, Mercer Capital helps clients resolve fair value reporting issues successfully.

We have the capability to serve the full range of fair value valuation needs, providing valuation opinions that satisfy the scrutiny of auditors, the SEC, and other regulatory bodies.

We also have broad experience with fair value issues related to public and private companies, financial institutions, private equity firms, start-up enterprises, and other closely held businesses. National audit firms consistently refer financial reporting valuation assignments to Mercer Capital.

Our professionals are nationally recognized as leaders in the valuation industry, and hold the most rigorous credentialing designations including the CFA, ASA, and CPA, among others, which are representative of the highest standards in the valuation and accounting industries. Mercer Capital has the institutional capability to tackle even the most uncommon or complex fair value issues. We understand the sensitivity of financial reporting timing needs and meet your deadline on time, every time.

Contact Us

Travis W. Harms, CFA, CPA/ABV
901.322.9760
harmst@mercercapital.com

Matthew R. Crow, ASA, CFA
901.685.2120
crowm@mercercapital.com

Lucas M. Parris, CFA
901.322.9784
parrisl@mercercapital.com

Sujan Rajbhandary, CFA
901.322.9749
sujanr@mercercapital.com

Whitney L. Faust
901.322.9741
faustw@mercercapital.com

Mercer Capital
5100 Poplar Avenue, Suite 2600
Memphis, Tennessee 38137
901.685.2120 (P)
www.mercercapital.com